

Global Restructuring and Development of Contract Farming Models of Contractual Agreements for Emergent Farmers

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Outline

- Introduction – Brief overview of the global restructuring of agrifood markets and definition of contract farming
- Field methodology – A geographical approach
- Empirical results – Contracts for small-scale farmers
- Discussion and conclusion

The global Restructuring of Agri-food Markets

- Trade liberalization, deregulation of agricultural markets
- Urbanization and growth in population density, increased disposable incomes, changes in consumer preferences
- Changes in procurement, processing, distribution and retail
 - consolidation of large retail chains (60% share of formal markets in South Africa) and agri-food processing companies
- Four pillars of restructuring:
 - Development of private standards
 - Establishment of centralized procurement
 - Shift from conventional to dedicated wholesalers/suppliers
 - Preferred supplier schemes (more vertical coordinated and integrated mechanisms which include both **explicit and implicit contracts**)

Focusing on contract farming

- Context:
 - Increasing attention on how improving market access for poorer farmers who face many constraints
 - Need to provide tools for public and private actors to generate concrete options to accommodate the poorer farmers in the commercial agribusiness sector
- Objectives of the study
 - To identify and to characterize contracts:
 - defined in its widest sense including marketing agreements, production contracts, as well as out grower schemes
 - To determine the conditions of the development of contracts
 - benefits and constraints from farmers' perspective
 - To provide guidance to the key stakeholders of the agricultural sector and to assess whether or not contract farming is a viable tool to improve market access for SSF

Defining Contract Farming (1/2)

- What is Contract Farming?
 - means by which people seek, identify and negotiate opportunities from exchange
 - An institutional arrangement operating as an intermediary between spot market and vertical integration
- All contracts are incomplete (oral or written) and present enforcement issues
 - subversion or opportunistic behavior, manipulating scheme rules, side selling

Defining Contract Farming (2/2)

- CF = system where a central processing, distribution or exporting firm procure from farmers according to modalities negotiated in advance
 - » Bauman 2000; Eaton and Shepherd 2001; Swinnen & Maertens 2007
- Contracts can be differentiated in 3 types according to the degree of delegation of the decisions:
 - *Market specification contracts*: future purchase agreements which determine quantity, timing and price of commodities to be sold
 - *Production management contracts*: specify the sorts of crops to be cultivated, some practices and the quality and standardisation through the provision of technical packages and credits
 - *Resources providing contracts*: directly shape and regulate the production and labour processes of the grower
 - » Bauman 2000
- Applied in different ways on the ground
 - Need of a better understanding – how applied & who is engaged?

Why contract farming?

- Contract farming as a risk sharing strategy
- Imperfect markets
 - high transaction costs, information asymmetry
- Asset specificity
- **Contract Farming and collective action**
- Reduced transaction costs
- Economies of scale is achieved
- Lower risks of contract default (peer pressure, joint collateral, etc.) from farmers

Methodology

- Study region: Tzaneen (Limpopo Province, South Africa)
 - Conducive agro-climatic conditions for vegetable, fruit and field crop production
 - Irrigation opportunities
 - An agricultural hub in the province
 - One of the major producing area for fruits and vegetables
 - Presence of commercial farming, by both large- and small-scale farmers (LSF/SSF) which create dynamic markets
 - Effective presence of Contract Farming in the area
 - Effective involvement of small-holders in contractual arrangements
- Geographic approach to capture the diversity of contracts (both formal and informal) with agribusiness and farmers as a focal point (i.e., no commodity specificity)
 - Identification of agri-businesses engaged in contracts with SSF
 - In-depth analysis of contracts and of the characteristics of farmers

Typology of Contracts (1/2)

- Five types of contracts were identified
- Contracts vary in their characteristics and modalities

Major characteristics	Resource Management for deep litter chicken Production Contracts	Production Management and Market Specification Contracts	Production Specification and Market Specification Contracts
Input provision	X	X	
Provision of credit for production		X	
Provision of technical Assistance	X	X	
Management of the production	X	X	
Specifications	X	X	X
Price fixed in advance	X	X	X
Formal (written) agreement	X	X	X
Seasonal/annual agreement		X	X
Long-term arrangement	X		
	Resource providing contracts (total integration)	Production management contracts	Market specification contracts

Typology of Contracts (2/2)

Major characteristics	Organic vegetable (Certification) Contracts	Production Management and Export Market Specification Contracts
Input provision		
Provision of credit for production		
Provision of technical Assistance		X
Management of the production		
Specifications	X	X
Price fixed in advance	X	X
Formal (written) agreement	X	X
Seasonal/annual agreement	X	X
Long-term arrangement		
	Market specification contracts	Combination of Production management and Market specification contracts

Major Characteristics of Contracts (1/5)

(1) Resource Management for deep litter chicken Production Contracts

- Commodity: industrial chickens **for domestic and local market**
- Formal -written contract (5 years)-linked to funding from government
- Specifications:
 - Farmer contracted to produce ready-to-slaughter birds on a fixed producer price
 - Company (Bushvalley farms) provides day-old chicks and all required inputs (food, medicines, etc.)
 - Company manages the entire production cycle (growth of chickens per cycle)
 - Company experts manage the automated environmentally controlled chicken houses
 - Farmer monitors the growth of the chickens (reports any problems to the company)
- Marketing:
 - Company catches chickens, transports to abattoir for slaughtering and selling
 - Farmer paid subsequent to marketing
 - Costs of production and management deducted prior to payment (1 month)

Types of farmers:

- Redistribution land (private) – 40ha to 120ha
- Individual farmers
- Government funding (infrastructure)
- Contract established in public/private partnership
- Nine (32%) of contracted farmers engaged

Major Characteristics of Contracts (2/5)

(2) Production Management and Market Specification Contracts

- Commodities: Peppadew and tomato for domestic market (supermarket)
 - Formal-written contract, renewable on a seasonal base
 - Specifications:
 - Types of chemicals and the expected standards of the products
 - Input provision and technical assistance:
 - The buyer (Peppadew International, APOL, Tiger brands) provides seedlings and technical assistance
 - Marketing:
 - Prices fixed in advance
 - Farmer supplies peppadew/tomatoes and cost of seedlings deducted prior to payment (3 weeks)
- (only one – cooperative farm – got funding from contractor)

Type of farmers

- Larger-scale – 40+ha (70%-emerging farmers)
- Own irrigation system
- Individual-private or previous home government farms
- Contract based on own initiative of farmer
- Ten (36%) and 18% of contracted farmers engaged for peppadew & tomatoes, respectively

Major Characteristics of Contracts (3/5)

(3) Production Specification and Market Specification Contracts

- Commodities: Citrus (oranges & grapefruits)
 - export market
 - Domestic market (fruit juice factory, Fresh produce market, supermarkets)
- Formal-written contract, renewable on a seasonal base
- Specifications:
 - The buyer (Lona, Dole) stipulates types of chemicals to be used and technical itinerary (time of application of pesticides and fertilizers)
 - Fruit quality stipulated prior to planting
- Input provision and technical assistance:
 - Very little monitoring – just punctuality verification
 - Emergency finance provided on request
- Marketing:
 - Farmer delivers citrus and paid after 1-3 months
 - Export oriented – contractor exports fruits

Type of farmers:

- Individual private land & former homeland government plots
- Larger-scale (12 to 300 ha)
- Own irrigation system
- Own initiative (farmers) & public/private partnership
- Four (36%) of contracted farmers engaged

Major Characteristics of Contracts (4/5)

(4) Organic Certification Contracts

- Commodities: Organic vegetables (green beans, green pepper, lettuce, butternuts, beetroot, sweet corn) for domestic market
- Formal-written, renewable on an annual basis (Woolworths)
- Specifications:
 - Vegetable quality, norms and standards are stipulated prior to planting (organic certification)
- Marketing:
 - Prices fixed in advance
 - Farmers deliver vegetables according to buyer's packaging requirements
 - Payment of the farmer one month after the delivery

Types of farmers:

- Contract between a buyer and a farmers' association
- Farmers' association was linked to buyer by a donor organization
- Both larger- and smaller- scale (emerging) farmers are involved
 - 10 to 50+ ha private land and communal land
- Own irrigation system
- Four (14%) of contracted farmers were engaged

Major Characteristics of Contracts (5/5)

(5) Production Management and Export Market Specification Contracts

- Commodities: kumquats (for exports)
- Formal-written seasonal contract
- Specifications:
 - The buyer (Capespan) stipulates types of chemicals and application standards
 - Fruit quality stipulated prior to planting (export standards)
 - Monitoring done sparingly to confer quality
- Payment 1-3 months after delivery (advance payments done)

Type of farmers:

- Individual private land
- Own irrigation system
- larger-scale (12+ha)
- Own initiative (farmers) with the backing of other already contracted farmers
- One (4%) of contracted farmers engaged

Main Conclusions

- Empirical evidence shows that the identified contracts are diverse
 - Great variations of the terms of the contracts
 - Few commodity specific contracts
 - => Difficult to come up with tailor-made contract types
- Few farmers (only 28!) are engaged in contracts with agribusinesses and supermarkets in the study region, while it is known as a dynamic agricultural production area
 - Concerns very low volume of production
 - Only the better-off farmers, characterized by specific trajectories and having benefited from case-specific support measures

Is CF really helpful to better access markets?
- Collective action has a catalytic effect on contract involvement for SSF
 - Several SSF engaged in CF subscribe to associations
 - Co-op farms are engaged in CF (with funding support from contractors/State)
 - Need for sustainable funding (external) from a reliable source - Operators are not covering transaction costs (shift from collectively organized procurement to individual one)
 - If public support is not available to cover them, farmers will act individually (with the engagement in CF becoming limited)

Efficiency of contracts – and thus CF - is anchored by external support